11.04.2024

Qi MacroVantage

MacroVantage scans all asset classes globally, looking for timely observations from Qi's AI driven framework.

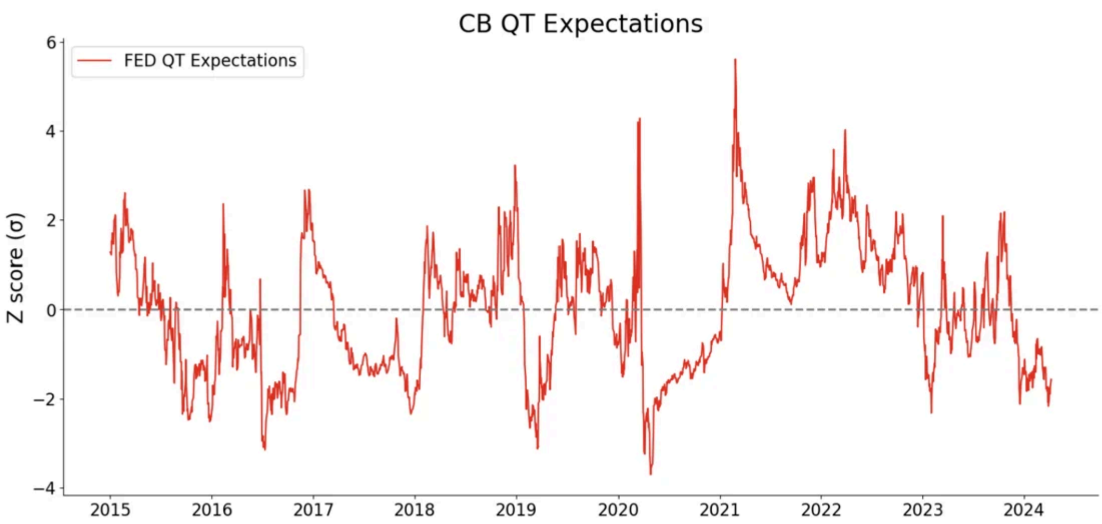
Where an asset price has become divorced from macro fundamentals and offers a potential trade opportunity; where factor leadership may be changing or regimes shifting; employing Qi factor sensitivities to run scenario analysis on critical themes.

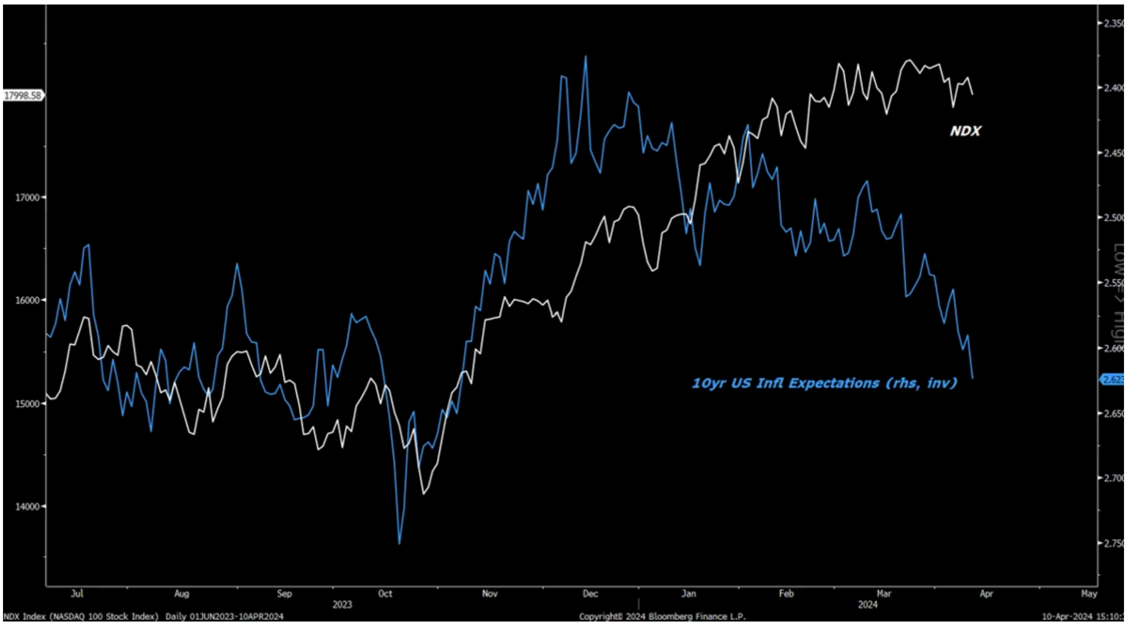
Topical, timely, machine-driven signals and observations.

1. Qi's US equity model momentum now fading, led by NASDAQ

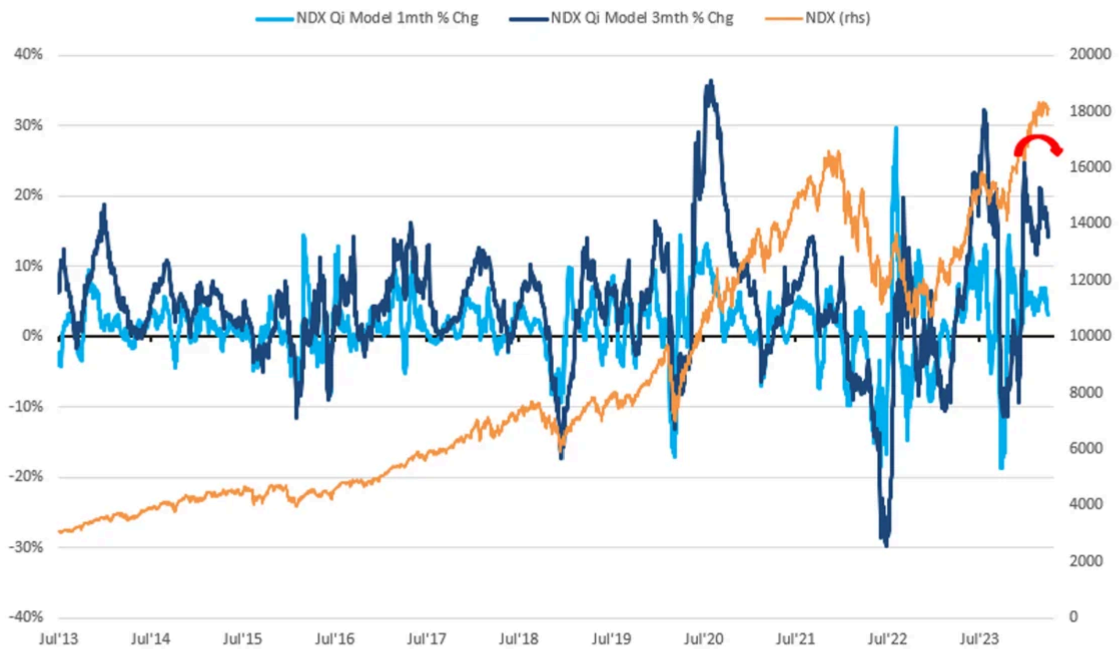
Just 3 months ago, 6 Fed cuts were being priced this year. Risky assets well digested the move from 6 cuts to 3 cuts as it coincided with rising growth expectations. However, from 3 cuts to a plausible zero cut scenario, equities will take note. Especially in light of the proximity of the September meeting to the US election.

In other words, the rate outlook uncertainty has just risen post the March CPI release. Into 2024, falling rate vol (which we use as a proxy for Fed QT expectations) has been one of the most supportive drivers for the US equity rally. However, in z-score terms, CB QT expectations are now sitting 2 standard deviations below trend – that is a poor risk-reward area given its mean-reversion tendency and not helped by the latest CPI release.





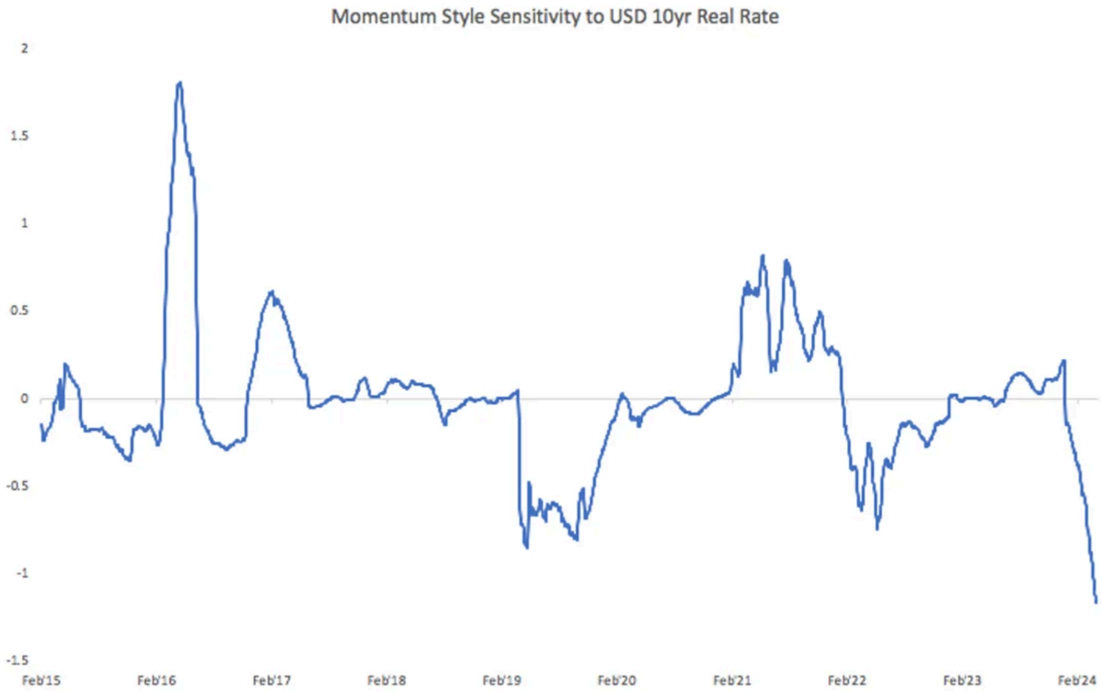
This is feeding through to Qi's model value for SPY and NDX. In particular, for the latter. Nasdaq macro-driven strength requires weaker commodities, a weaker dollar, fading real yields and inflation expectations. The chart above shows the inverse relationship between inflation expectations and NDX. The chart below shows NDX Qi model value momentum is starting to fade (shown below as the 3mth % change and 1mth % change).

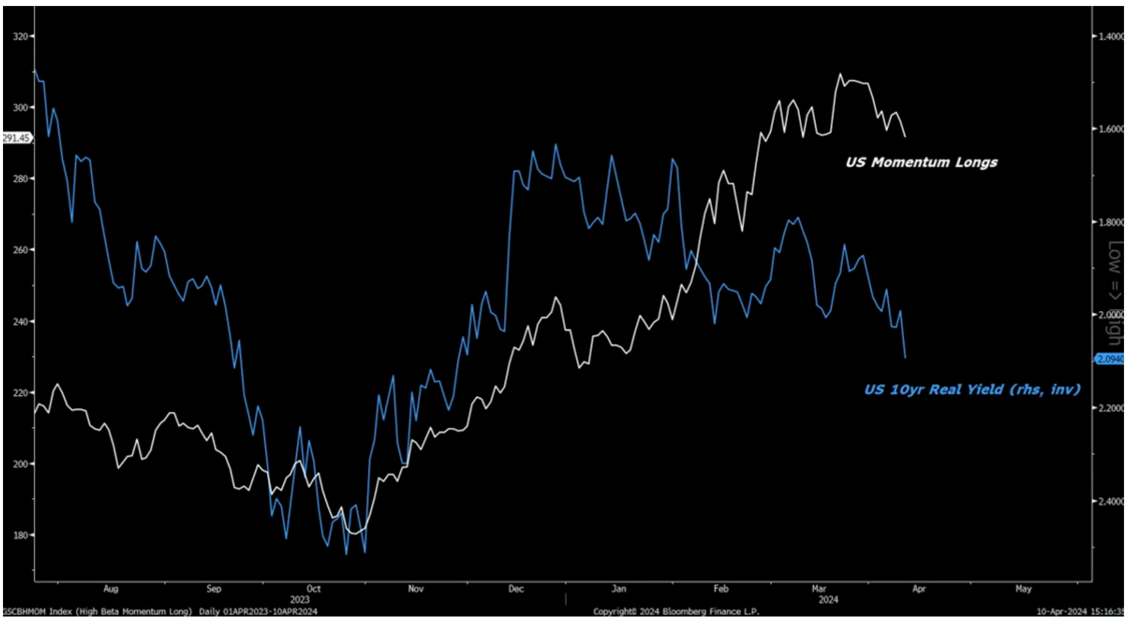


2. Under the hood, the US momentum trade was relying on a soft CPI print & supportive financial conditions - is the party over?

The US momentum trade has reflected investor comfort with key secular themes over the last year (e.g. AI / Biotech). However, through a macro lens, the Qi machine shows a high reliance of Momentum to lower real yields, credit spreads and rate vol i.e. supportive financial conditions.

See the first chart below showing the high negative Qi sensitivity of the Momentum style to real yields. The second chart illustrates the inverse relationship, with the divergence most notable since February.





3. Screening for sectors / ETFs most vulnerable to higher inflation expectations / higher rate vol

In a note on 26th March "[Qi Scenario Spotlight: What if this is a Fed Error?]", we screened for winners and losers from a scenario of higher inflation expectations alongside higher Fed QT expectations (a proxy for rate volatility).

Commodity-sensitive equities outperform – Energy, Materials, GDX. Financials (in particular regional banks), Real Estate, Technology underperform. In other words, increase exposure to real assets if the dollar’s secular bull run come under threat.

See the first chart below. The second chart comes straight from the Qi portal to simply show sector winners / losers from higher inflation.

There is a caveat that if the initial reaction of higher rates & higher dollar persists, GDX will struggle for now. GDX strength is reliant on a weaker dollar.

Scenario: Higher Inflation Expectations / Higher Rate Vol

Winners	Losers
S5ENRS vs. S5FINL	S5HLTH vs. S5ENRS
S5ENRS vs. S&P500	S5UTIL vs. S5ENRS
S5MATR vs. S5FINL	S5INDU vs. S5ENRS
S5INDU vs. S5FINL	S5MATR vs. S5ENRS
S5HLTH vs. S5FINL	S5RLST
S5TELS vs. S5FINL	S5FINL
S5TELS vs. S&P500	S5TELS vs. S5ENRS
S5MATR vs. S5INDU	S5CONS vs. S5ENRS
S5MATR vs. S&P500	S5COND vs. S5ENRS
S5ENRS	S5INFT
GDX	VB (Vanguard Small Caps)
OIH	KBE

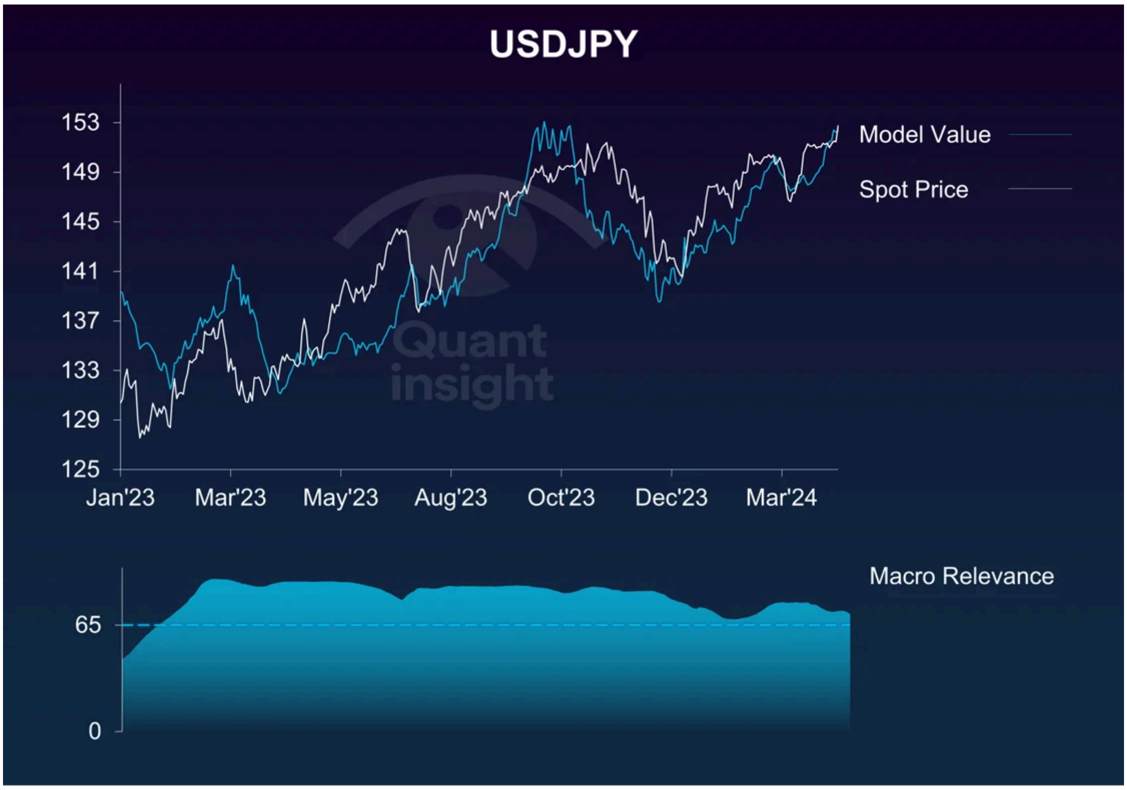
ST/LT	Model Name	Asset Class	Confidence (%)	Change 1M	Valuation Gap σ	Change 1M	Total ▼	US 10Y Infl. Expec. [(USD 10Y
LT	US Energy	Equity	77%	↑ 22%	0.32	↓ -0.48	0.61	0.61
LT	US Materials	Equity	87%	↑ 4%	-0.36	↓ -1.38	0.17	0.17
LT	US Industrials	Equity	76%	↓ -4%	-0.82	↓ -0.8	0.13	0.13
LT	US Consume...	Equity	37%	↓ -16%	-0.79	↓ -0.32	0.11	0.11
LT	US Consume...	Equity	78%	↑ 7%	-0.33	↓ -1.43	0.07	0.07
LT	US Commun...	Equity	59%	↑ 11%	-0.22	↓ -0.25	0.01	0.01
LT	US Utilities	Equity	69%	↑ 0%	1.20	↑ 0.59	-0.01	-0.01
LT	US Health Care	Equity	68%	↑ 11%	-1.09	↓ -1.52	-0.07	-0.07
LT	US Technology	Equity	72%	↑ 3%	-0.42	↓ -0.49	-0.24	-0.24
LT	US Financial	Equity	96%	↑ 1%	-0.45	↓ -0.63	-0.27	-0.27
LT	US Real Estate	Equity	90%	↑ 0%	-0.44	↓ -0.52	-0.42	-0.42

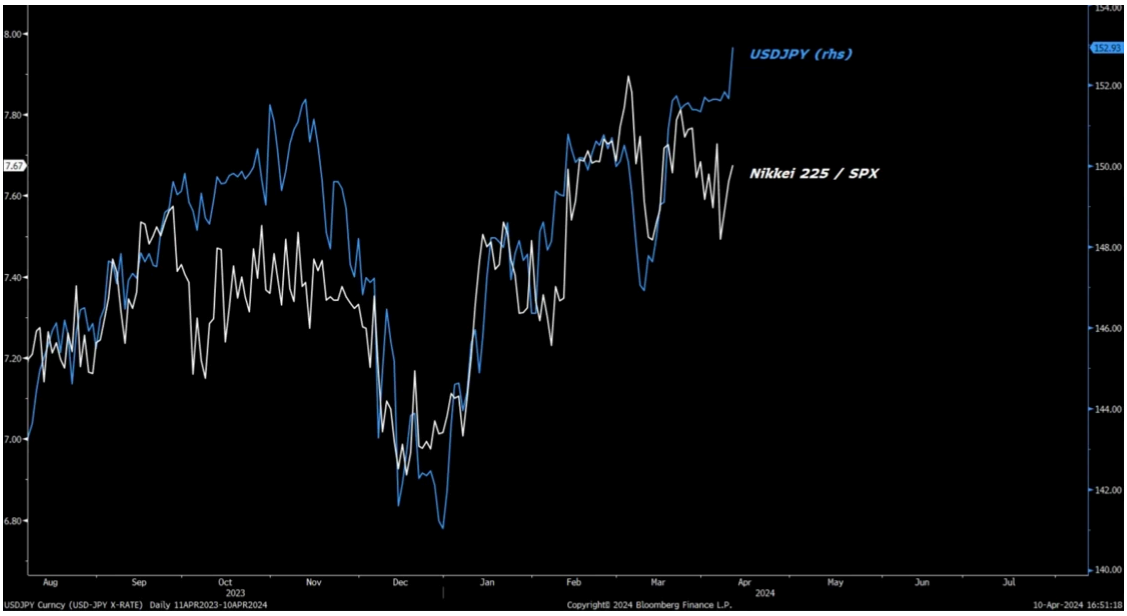
4. USDJPY - fundamentals versus jawboning

Qi's USDJPY model is displaying renewed macro momentum. Model value has risen 2.8% in the last month. That's the one of the biggest 4 week moves across G10 fx pairs.

There's no valuation edge - spot sits close to our 152.64 fair value. It is more a reminder that fundamentals - particularly the moves in US yields & commodity markets - point to a weaker Yen. The authorities may be moving through the gears on verbal intervention, but they are fighting strong headwinds.

It is also a reminder that global investors see the MoF's headache as a tailwind for Japanese equities. The second chart shows the role a weak Yen plays in helping Nikkei perform versus US stocks.



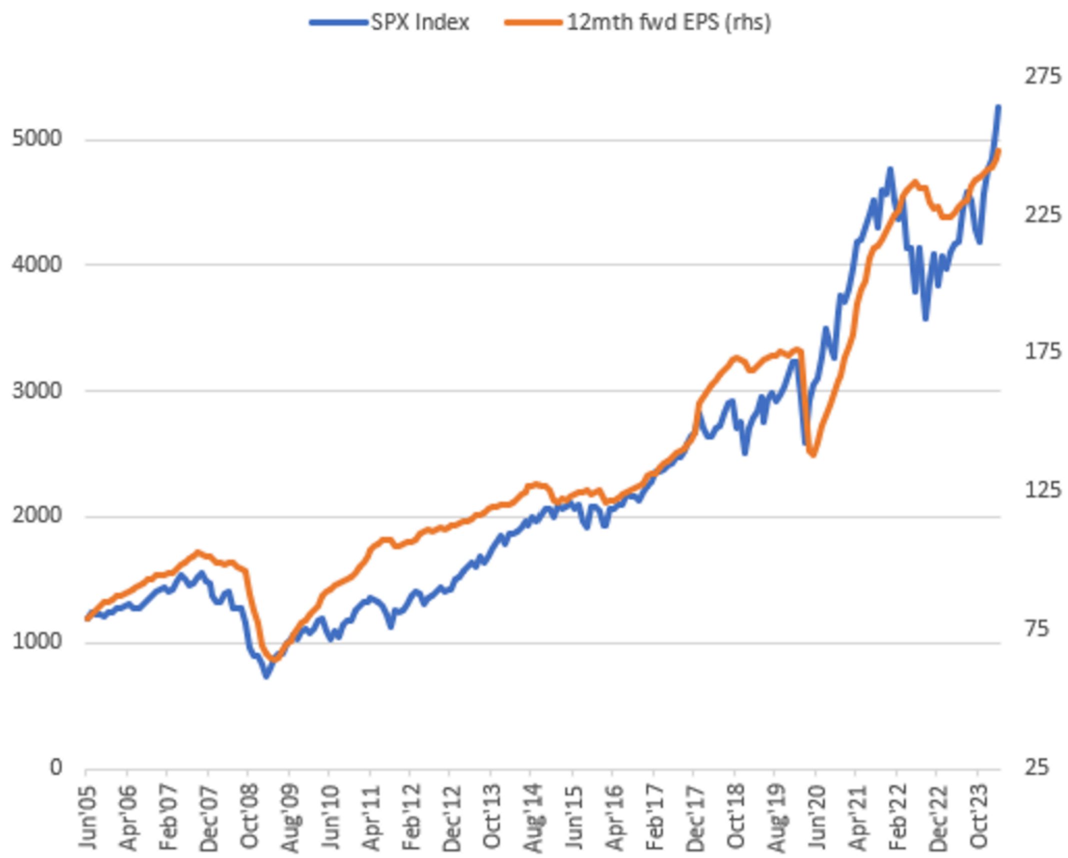


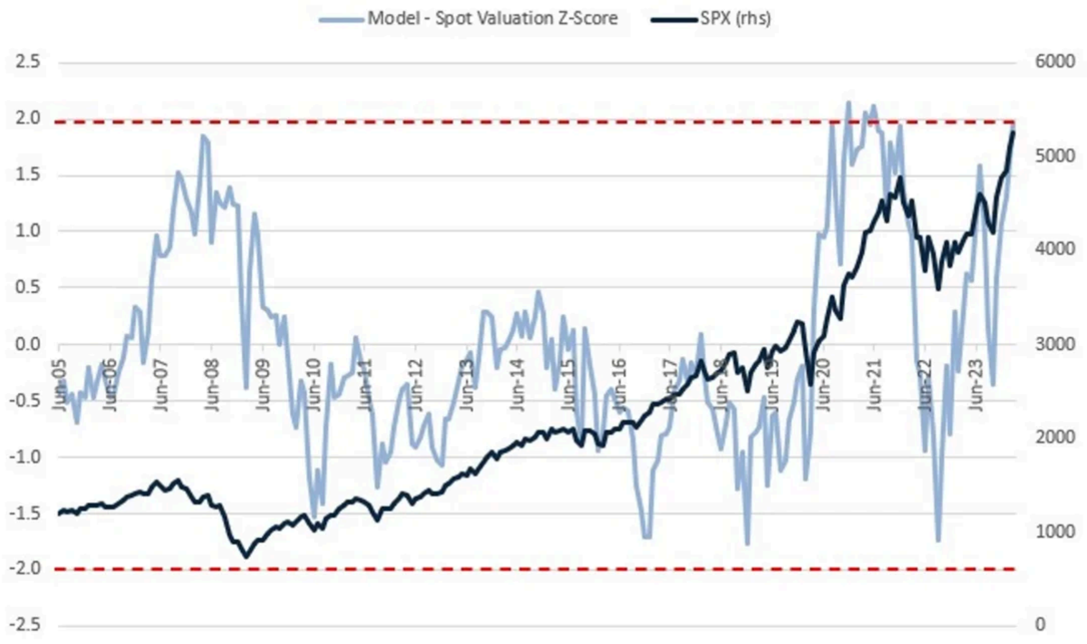
5. *Heading into earnings season, the S&P500 macro beta impulse is rising - a big onus on earnings.*

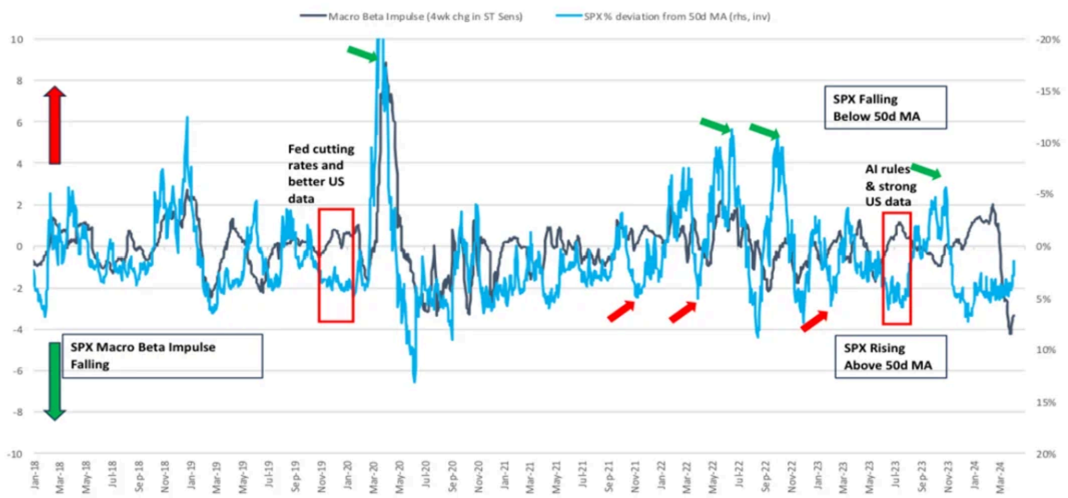
The timing of this CPI release is poor – we are just about to head into earnings season. Given the multiple expansion we have seen in the S&P 500, the index is trading as if forecast estimates through to 2025 have already been banked. See the first chart.

The second chart shows the deviation of SPX 12mth fwd PE and PB (combined into a single measure) relative to its model value from a simple regression to credit spreads, the dollar and real yields – another way of showing valuations are extended.

Finally, the third chart reminds us that the S&P 500 macro beta impulse is now rising from multi-year lows. When macro sensitivities rose over Q4 last year it was supportive for risky assets given the favourable moves in the macro data itself. This time around, further mean-reversion of the impulse may well coincide with an elevated risk of the Fed comprising its inflation-fighting credibility.







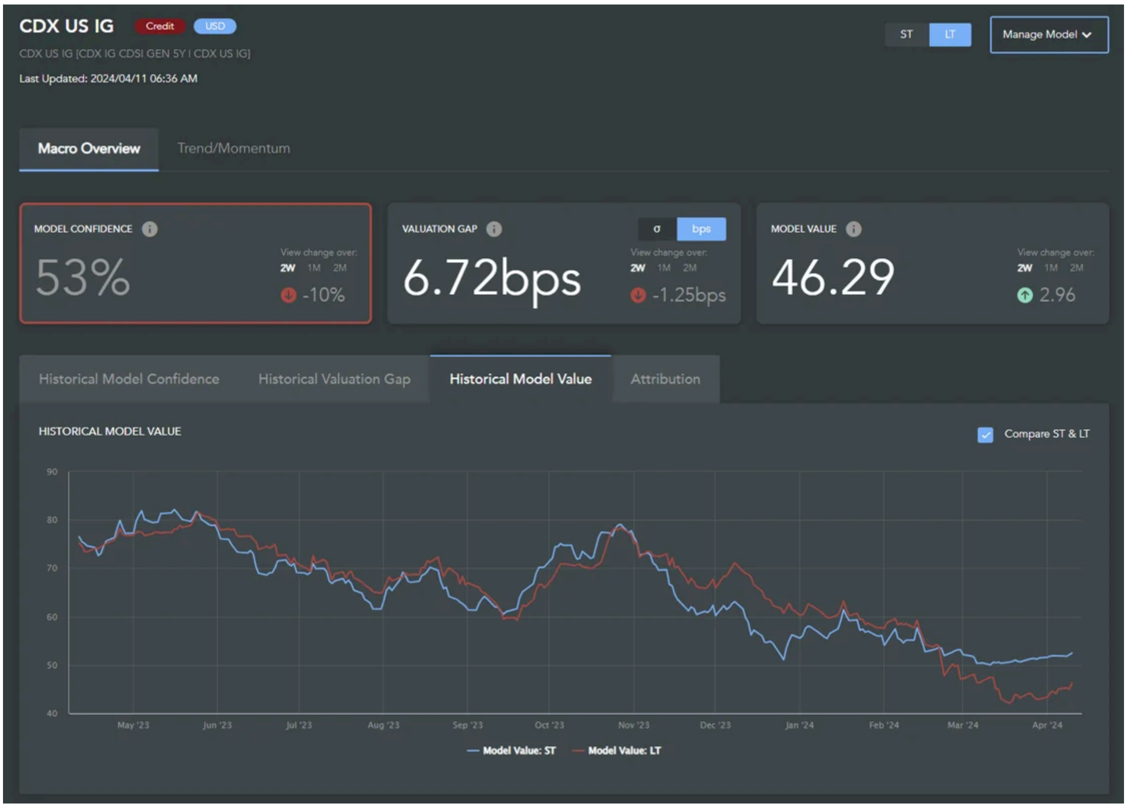
6. Credit - this time it's different?

In 2023, credit was the proverbial dog that refused to bark - even after aggressive rate hikes & a mini-financial crisis in March, credit conditions never really tightened. Nothing (systematically important) has broken, yet.

To date, this re-pricing of US bond yields has been a grind; and credit spreads have continued to tighten. The net result being overall credit conditions haven't materially worsened.

Credit may be relying on the same argument as equities - a strong economy / earnings offset the lack of rate cuts. But, after this week's CPI, will this more aggressive move in UST yields change the dynamic?

Any spread widening would raise a possible red flag about deteriorating credit quality & a tightening of financial conditions more broadly. We are watching Qi model value in US Investment Grade Credit & the JNK ETF closely to see if macro momentum is definitively turning.



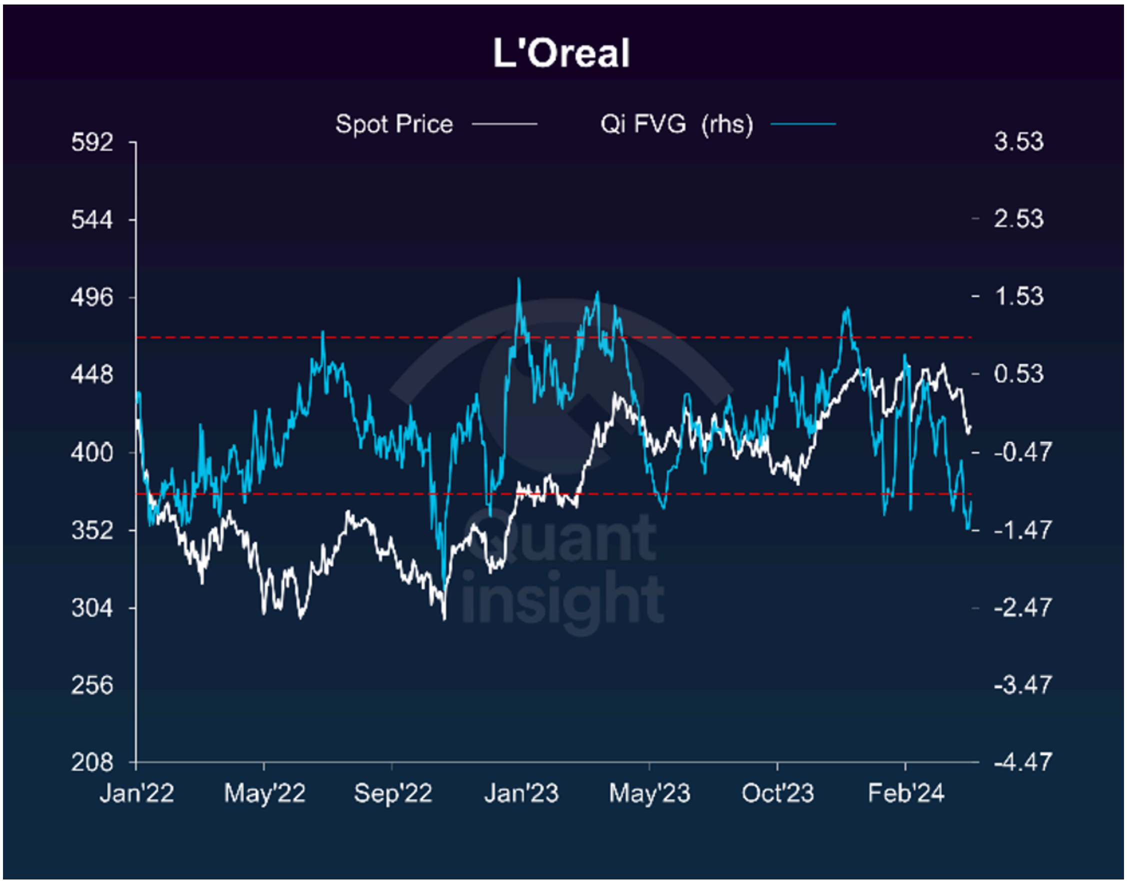
7. L'Oreal - "because it's worth it", on macro

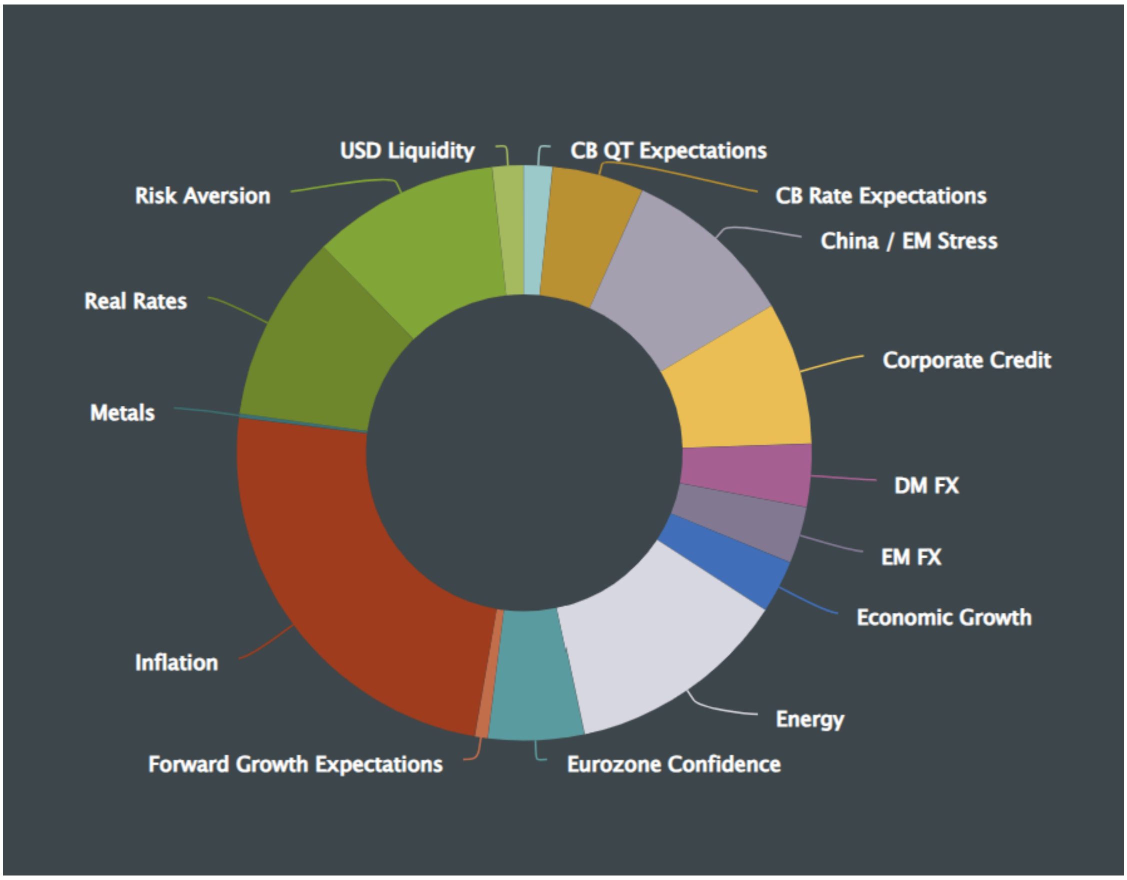
L’Oreal is 1.2 standard deviations cheap on Qi’s macro model valuation
It has only been cheaper 5% of the time in the last 12 months, on a standard deviation basis.

The key drivers are EU inflation and oil price – L'Oreal wants both to drop, unlike the US, EU inflation has been heading downwards.

L'Oreal is also a play on a potential China consumer stimulus (North Asia is a quarter of L'Oreal revenues) – we have seen Thailand recently announce a $14 billion cash handout program to stimulate the economy, could China follow?

Earnings are next week.





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